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IN THE  
**Supreme Court of the United States**

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OCTOBER TERM, 1941

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NO. 1176

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L. W. MESTA, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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**PETITION FOR WRIT OF CERTIORARI.**

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## INDEX.

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	PAGE
Opinions Below .....	1
Jurisdiction .....	2
Question Presented .....	2
Summary Statement of the Matter Involved.....	2
Specification of Errors to Be Urged.....	5
Reasons Relied on for the Allowance of the Writ...	6
Appendix .....	13

### Cases Cited.

Commissioner v. Bennett B. Bristol, 121 F. (2d) 129	9
Commissioner v. A. Crawford Greene, 119 F. (2d) 383; cer. den. .... U. S. ...., 86 L. Ed. 76.....	10
Eisner v. Macomber, 252 U. S. 189, 207.....	11
Halliwell, Walter S., v. Commissioner, 44 B. T. A. 640 .....	7, 8
Harrison v. Schaffner, 312 U. S. 579.....	12
Helvering v. American Chicle Co., 291 U. S. 426....	11
Helvering v. Fitch, 309 U. S. 141.....	12
Helvering v. Horst, 311 U. S. 112.....	12
Helvering v. United States Trust Company et al., 111 F. (2d) 576, cer. den. 61 S. Ct. 45.....	10
Helvering v. Wilshire Oil Company, Inc., 306 U. S. 628 .....	7
Kalman Hirsch v. Commissioner, 115 F. (2d) 656...	11
Pearce v. Commissioner, .... U. S. ...., decided March 9, 1942, 86 L. Ed. 675.....	12
United States v. Kirby Lumber Company, 284 U. S. 1 .....	11

## *Index.*

### **Statutes and Authorities.**

	PAGE
Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 303 (d) . . .	9
Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 804 . . .	10
Regulations 86, Art. 22 (b) (3) . . . . .	10
Illustrative Cases Bulletin 6, 1941 CCH, Par. 0104D	8
University of Pennsylvania Law Review, Vol. 90, No. 5, March 1942, p. 628 . . . . .	9

### **APPENDIX.**

#### **Statutes and Regulations.**

##### **INCOME TAX.**

Revenue Act of 1934, c. 277, 48 Stat. 680, (U. S. C., Title 26) ; Sec. 22, . . . . .	13
Sec. 111 . . . . .	14
Sec. 112 . . . . .	14
Sec. 117 . . . . .	14
Regulations 86, Revenue Act of 1934, Art. 22 (b) (3)	15

##### **GIFT TAX.**

Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 804, Sec. 501 (a) and (b) ; Sec. 503 . . . . .	15
Regulations 79, Art. 1 and Art 8 . . . . .	16

##### **ESTATE TAX.**

Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 303 (d) . .	17
Regulations 80, Art. 15; Art. 23 . . . . .	17

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Respondent.**

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**PETITION FOR WRIT OF CERTIORARI.**

*To the Honorable, the Chief Justice and  
Associate Justices of the United States:*

L. W. Mesta, petitioner above named, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above entitled cause on November 25, 1941, reversing by divided opinion the decision of the Board of Tax Appeals.

**Opinions Below.**

The opinion of the Board of Tax Appeals (R. 3-14) is reported in 42 B. T. A. 933. The opinion of the Circuit Court of Appeals (R. 32-36) is reported in 123 F. (2d) 986.

**Jurisdiction.**

The judgment of the Circuit Court of Appeals was entered November 25, 1941 (R. 37). The time within which to file this petition was extended to April 25, 1942, by order of this Court entered February 11, 1942 (R. 38). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

**Question Presented.**

Whether the delivery of corporate stock by a husband to his divorced wife pursuant to an agreement signed by the wife after the divorce hearing but prior to decree is a transaction from which income is realized by the husband, or is a taxable gift, or is a nontaxable division of property between husband and wife where all marital obligations of the husband are discharged by the divorce decree.

**Summary Statement of the Matter Involved.**

The facts were stipulated and briefly are as follows:

Petitioner, an individual residing at Pittsburgh, Pennsylvania, duly filed his Federal Income tax return for the calendar year 1935 with the Collector of Internal Revenue for the Twenty-third Collection District of Pennsylvania. (R. 17)

Petitioner and his former wife, Cora Jane Mesta, were married August 19, 1921, and lived together until they separated on October 12, 1934. No issue resulted from the marriage. (R. 17)

On February 14, 1935, Cora Jane Mesta filed a libel in divorce in the Court of Common Pleas of Allegheny

County, Pennsylvania, praying for a decree divorcing her and petitioner "from bed and board." On March 5, 1935, petitioner filed a rule for a bill of particulars and on March 19, 1935, a bill of particulars was filed by said Cora Jane Mesta. On March 20, 1935, petitioner filed an answer to said bill of particulars. On March 8, 1935, the prayer of the libel was changed at the request of libellant to a prayer for a decree "from the bonds of matrimony." A hearing was had on the divorce action on April 12, 1935, and on April 15, 1935, a final decree was entered by which petitioner and his former wife were "divorced and separated from the bonds of matrimony." (R. 18)

Under the terms of an agreement signed by petitioner on March 22, 1935, and by his former wife on April 13, 1935, petitioner agreed to deliver to his former wife 5200 shares of the common stock of Mesta Machine Company, a diamond ring, a Cadillac automobile, a set of golf clubs, a golf bag, all household furnishings in their home, and agreed to give up any claim he might have against her property or estate by reason of the marriage relationship; and his former wife agreed that the home which was owned by them as tenants by the entireties should vest in petitioner and that the property transferred to her should be in complete satisfaction of all claims on her part for support and in lieu of all rights she might have or acquire against the property or estate of petitioner by reason of the relationship of husband and wife (R. 18-19; Ex. E, R. 22-26).

On April 17, 1935, petitioner, in accordance with the terms of the aforesaid agreement, delivered to his former wife the 5200 shares of Mesta Machine Company common and on April 25, 1935, deeds for the purpose of vesting in petitioner title to the home were recorded. The fair market value of 5200 shares of Mesta Machine

Company common on April 17, 1935, was \$156,975 and the cost or base to petitioner of the 5200 shares transferred to his former wife was \$7,574.56 (R. 19).

As of April 13, 1935, petitioner was possessed of an estate in personalty of approximately \$1,150,000 and the value of the real estate owned by petitioner and his wife was approximately \$35,000. The household furnishings had a value of \$28,000 and his former wife claimed them and the other miscellaneous property mentioned in the agreement as her own property. (R. 19)

On April 17, 1935, petitioner was 45 years of age and his wife was 57 years of age. The present worth of \$1.00 payable to a woman now aged 57 at the death of her husband now aged 45, assuming she outlives him, is 0.187. (R. 19)

On or about March 9, 1936, petitioner filed a gift tax return, reporting thereon a gift of 5200 shares of Mesta Machine Company common to his former wife and paid gift tax in the amount of \$3,346.13. (R. 20)

On or about November 26, 1937, petitioner filed a protective claim for refund of gift tax paid as aforesaid on the ground that if the transaction was held to be a sale no gift was involved, and on or about December 21, 1938, a certificate of overassessment for the gift tax paid for both the years 1936 and 1937 and interest thereon was issued in the amount of \$7,837.64. On or about March 31, 1939, the Collector at Pittsburgh gave to petitioner a check issued by the Treasurer of the United States for the amount of the overassessment and interest. Counsel for petitioner advised the Collector on March 2, 1939, that this proceeding was pending in the Board of Tax Appeals and that acceptance of the check should in no way prejudice petitioner's rights in this



proceeding and this position was reiterated when counsel for petitioner wrote the Collector on or about April 1, 1939, acknowledging receipt of the check. (R. 20-21, Exs. G, I and K, R. 27-30) <sup>1</sup>

Respondent determined that petitioner had realized capital gain in the amount of \$149,400.44, being the difference between his cost of \$7,574.56 and the fair market value of the stock (\$156,975.00) on the date of transfer, and determined a deficiency in tax of \$31,163.18.

The Board of Tax Appeals reversed the respondent and determined that no gain had been realized by petitioner by virtue of the transaction. (R. 3-14)

The Circuit Court of Appeals, having first heard argument before a three-judge court and then, on its own motion, before a five-judge court, reversed the Board with two Judges dissenting. (R. 32-36)

#### **Specification of Errors to Be Urged.**

The Circuit Court of Appeals erred:

1. In holding that the transfer of stock from the husband to his divorced wife resulted in the realization of taxable income.
2. In holding that the wife surrendered property having an ascertainable value.
3. In holding that the transfer of stock from husband to his divorced wife was not a gift.
4. In holding that the transfer of stock from husband to his divorced wife was not a marriage settlement.

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1. Refund for 1937 resulted from application of the general exemption not used in 1936 as a result of the 1936 refund.

5. In holding that the transfer of stock from husband to his divorced wife was not a division of property.

6. In failing and refusing to hold that all obligations of the husband to his wife had been discharged by the divorce decree.

7. In failing and refusing to hold that the transfer of the stock did not satisfy any obligation of the husband.

8. In reversing the decision of the Board of Tax Appeals.

#### **Reasons Relied on for the Allowance of the Writ.**

1. The case presents an important question of federal law involving the construction and administration of the federal income and gift tax acts, which should be settled by an authoritative decision of this Court. It involves the basic and far-reaching question whether transactions of this character result in the realization of taxable income, or in the making of a taxable gift, or in a non-taxable division of property between husband and wife. The Board of Tax Appeals held that the transaction was a non-taxable division of property. The Circuit Court of Appeals held that the transaction created an income tax liability on the husband.

The question was considered sufficiently important to merit review by a five-judge court and was sufficiently doubtful to result in a dissent by two judges of that court on the basis of the opinion of the Board of Tax Appeals.

If the decision of the Circuit Court of Appeals is allowed to stand it means

(a) that money settlements made by a husband on his wife, *irrespective of divorce or separation*, in consideration of a release by the wife of her statutory rights and of his obligation to support her, will not be subject to gift tax. Men may so arrange their affairs that all future transactions of this character may be consummated by money payments rather than by transfers of property, thus eliminating both gift and income taxes on the transaction—a loophole of great magnitude is created, not closed;

(b) that, if followed to its logical conclusion, the wife exchanged her inchoate property rights having no cost or other base to her for stock having a fair market value of \$156,975, from which exchange she would realize a taxable gain of \$156,975—an astounding proposition, but a logical result; and

(c) that the husband by transferring high cost stock, after divorce, could take a capital loss.

Petitioner is advised that the Gift Tax Unit of the Bureau of Internal Revenue is now closing transactions of this character by the imposition of a gift tax and that at the same time the Income Tax Unit of the same Bureau, is imposing an income tax liability in other but similar cases.

The question is now pending in the Circuit Court of Appeals for the Second Circuit in the case of *Walter S. Halliwell*, 44 B. T. A. 640.<sup>2</sup> There the Board in a fifteen to one report followed the decision in the instant case. Petition for review was filed by the Commission prior to the decision of the court below in the instant

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2. Cf. *Petitions for Writ of Certiorari in Helvering v. Wilshire Oil Company, Inc.*, No. 163 October Term, 1938, filed June, 1938, No. 1 October Term, 1939, filed March, 1939, granted April 3, 1939, 306 U. S. 628.

case. On January 28, 1942, subsequent to the decision of the court below in the instant case, the Commissioner filed a second motion to extend the time within which to complete and transmit the record in the *Hallinwell* case on the ground that it would appear undesirable to prepare a record on review pending the final outcome of the *Mesta* case, thus recognizing that an authoritative decision by this court was desirable.

The importance of the question is further emphasized by the following statement in the opinion of the Board of Tax Appeals:

"To hold that a man has realized taxable income by giving up a substantial portion of his property seems to us unreasonable and not justified either under general law or under the Revenue Act."

It is further emphasized by the editors of Commerce Clearing House in Illustrative Cases Bulletin 6, 1941 CCH, Par. 0104D:

"In principle, a property settlement arrangement of this kind should not be held to constitute such a closed transaction as will require the husband to account for a more or less mythical gain, as measured by the assumed excess valuation of the rights surrendered by the wife (a valuation extremely difficult to arrive at and apt to be of a largely hypothetical character) as compared with the basis of the property transferred in satisfaction of such rights. The idea that there may be gain to account for under such circumstances has its origin in the conception that what takes place is an *exchange* between husband and wife of property rights. However it would appear that this conception is not actually in accord with the true nature of the transaction and that what really occurs is not an *exchange* but rather a *severance* or *division*

of the respective property rights of the spouses, akin, in principle (though different in the technical legal sense), to a partition of property by tenants in common."

Compare article in University of Pennsylvania Law Review Vol. 90, No. 5, March 1942, p. 628.

2. The decision of the court below is in conflict in principle with the decision of the Circuit Court of Appeals for the First Circuit in *Commissioner v. Bennett B. Bristol*, 121 F. (2d) 129. In that case the husband, pursuant to an ante-nuptial contract, purchased two annuities for his wife and transferred two pieces of realty to himself and her as tenants by the entireties. In return, she relinquished all her statutory rights in certain stock owned by him. The Circuit Court of Appeals, reversing the Board, held that the wife's release of her statutory rights was not adequate and full consideration in money or money's worth; that the estate and gift tax acts were in *pari materia*; that the 1932 amendment to Section 303(d) of the Revenue Act of 1926 providing that release of dower, statutory or other marital rights "shall not be considered to any extent a consideration in money or money's worth" furnished the basis for the same definition with respect to the gift tax act; that the rights surrendered by the wife were incapable of valuation; and that the transfer by the husband to the wife was subject to a gift tax.

In the instant case, the court below held without any discussion of the *Bristol* case: "Obviously the transfer was not a gift or a marriage settlement as contended by the respondent",<sup>3</sup> and that the value of the stock was the measure of the rights surrendered by the wife.

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3. The *Bristol* case was decided by the Board on June 28, 1940, 42 B. T. A. 263. The *Mesta* case was decided October 10, 1940, and the Commissioner, in February 1941, advised petitioner's counsel that in his opinion the decisions were conflicting. Both decisions were reversed by the Circuit Courts of Appeals and the conflict still continues.

3. The decision of the court below is likewise in conflict in principle with the decision of the Circuit Court of Appeals for the Second Circuit in *Helvering v. United States Trust Company et al.*, 111 F. (2d) 576, cer. den. 61 S. Ct. 45. In that case the husband made an agreement with his wife a few months prior to a divorce which provided for payments to her of \$2,500 a month during her life, out of which she was to support herself and maintain a daughter during the time that the daughter resided with her. Pursuant to one of the terms of the agreement, the decedent, six months later, exercised an option to discharge his obligations by setting up a trust. The wife was given power to appoint approximately fifty per cent of the trust by will. The court held that the wife's right of support was a marital right within the meaning of Section 804 of the Revenue Act of 1932 and therefore there was no consideration in money or money's worth for the transfer of the corpus from the husband to the trustee except to the extent of the value at decedent's death of the obligation of the wife to support the child. It follows that if the wife's right to support is a marital right, the settlement thereof is a marriage settlement, contrary to the opinion of the lower court in the instant case. (Reg. 86, Art. 22 (b) (3), Appendix)

4. The decision of the court below is likewise in conflict in principle with the decision of the Circuit Court of Appeals for the Ninth Circuit in *Commissioner v. A. Crawford Greene*, 119 F. (2d) 383; certiorari denied October 13, 1941, . . . , U. S. . . . , 86 L. Ed. 76. In that case a California probate court had ordered the estate of an incompetent to make certain payments for the maintenance and support of the incompetent's two adult daughters who were incapable of maintaining themselves by work. The court held that the discharge of the legal obligation imposed by the California law

was not "consideration" within the meaning of the gift tax act and therefore the payments for support constituted taxable gifts. In the instant case the court below made the assumption that one who spends money or gives property of a fixed value for an unliquidated claim is getting his money's worth (consideration).

5. The decision of the court below is in conflict in principle with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Kalman Hirsch v. Commissioner*, 115 F. (2d) 656. In that case the court held that a solvent mortgagor did not realize income by paying off a mortgage for less than the full debt because he received nothing of exchangeable value. The court said:

"A transaction whereby nothing of exchangeable value comes to or is received by the taxpayer does not give rise to, or create, taxable income. *Eisner v. Macomber*, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A.L.R. 1570; *Reuben v. Commissioner*, 8 Cir., 97 F. 2d 926."

The petitioner's situation differs from that in the debt-discharge cases such as *United States v. Kirby Lumber Company*, 284 U. S. 1, and *Helvering v. American Chicle Co.*, 291 U.S. 426, since in those cases the taxpayer had originally received money or something of exchangeable value at the time of the creation of the debt. Here, assuming that an obligation was discharged by the transfer of the stock although, by law, his obligations were discharged by the divorce decree, this petitioner never received anything from his divorced wife of exchangeable value—nothing for his separate use, benefit and disposal. The decision in holding that he has received income is contrary to the definition of income announced in *Eisner v. Macomber*, 252 U.S. 189, 207, which has been frequently cited and followed. The question whether

that definition should now be limited and narrowed in scope is an important question which merits review by this Court.

6. The court below has applied the rule of *Helvering v. Horst*, 311 U. S. 112, involving a transfer of accrued income, to this case, involving a transfer of income-producing property, contrary to the expressed reservation of the question in *Harrison v. Schaffner*, 312 U. S. 579 and to the distinction pointed out in *Josephine S. Pearce v. Commissioner*, . . . U. S. . . ., decided March 9, 1942, 86 L. Ed. 675.<sup>4</sup> The question whether the rule of *Helvering v. Horst* should be so extended is an important question which, having been reserved by this Court, now merits review.

Respectfully submitted,

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4. In the Pearce case certiorari was granted because of the manner in which the lower court applied the rule of *Helvering v. Fitch*, 309 U. S. 141.



